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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| In the Matter of | ) | |
| | ) | |
| 1993 Annual Access Tariff Filings | ) | CC Docket No. 93-193 |
| GTE Telephone Operating Companies | ) | Transmittal No. 781 |
| GTE System Telephone Companies | ) | Transmittal No. 38 |
| | ) | |
| National Exchange Carrier Association | ) | CC Docket No. 93-123 |
| Universal Service Fund and Lifeline | ) | |
| Assistance Rates | ) | |
| | ) | |
| GSF Order Compliance Filings | ) | |
| GTE Telephone Operating Companies | ) | Transmittal No. 796 |
| GTE System Telephone Companies | ) | Transmittal No. 48 |
| | ) | |
| Bell Operating Companies' Tariff for the | ) | CC Docket No. 93-129 |
| 800 Service Management System and 800 | ) | |
| Data Base Access System | ) | |

# REBUTTAL OF GTE


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operating companies

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## SUMMARY

This Rebuttal is filed in response to the oppositions filed against GTE's Direct Case justifying its 1993 Annual Access filing. The oppositions addressed three issues: whether GTE had properly justified including the Transitional Benefit Obligation ("TBO") as an exogenous cost; whether "add-back" should be included in the calculation of sharing and lower formula adjustments; and whether the LIDB Query charge had been assigned to the proper price cap basket. In reply, GTE submits:

1. The Commission should provide for exogenous treatment for the TBO and related components of OPEBs inasmuch as they constitute a reasonable and necessary cost coming within the exogenous definition, it will not be unduly complex to implement, and any concerns can be offset by GTE's true up proposal.

2. The issues of add-back should be deferred to the rulemaking proceeding since the issue was not addressed in the original price cap rules. If new rules are adopted any rate adjustment should be prospective.

3. A new service category should not be created for the LIDB Query. Not only is a new service category unnecessary, but creation of a separate service category conflicts with the Commission's original Price Cap goal of simplifying regulation of LECs and would undermine the Commission's objective to encourage innovation and introduction of new services by the LECs. Moreover, a separate service category for LIDB Query may cause unwanted rate adjustments.

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**REBUTTAL OF GTE**

GTE Service Corporation, on behalf of its GTE affiliated domestic Telephone Operating Companies (the "GTOCs") and the GTE System Telephone Companies (the "GSTCs") (collectively, "GTE"), hereby submit this Rebuttal to Oppositions to GTE's Direct Case in the above-referenced proceeding.

## BACKGROUND

On July 27, 1993, GTE submitted its Direct Case in response to issues associated with the 1993 Annual Access tariff filing which were designated for

investigation in the Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, DA 93-762, released June 23, 1993.

On August 24, 1993, oppositions were filed by American Telephone & Telegraph ("AT&T"), Ad Hoc Telecommunications Users Committee ("Ad Hoc"), MCI Communications Corporation ("MCI") and Allnet Communication Services, Inc. ("Allnet"). The oppositions addressed three issues: whether GTE had properly justified including the Transitional Benefit Obligation ("TBO") as an exogenous cost; whether "add-back" should be included in the calculation of sharing and lower formula adjustments; and whether the LIDB Query charge had been assigned to the proper price cap basket.

As will be shown herein, the oppositions are without merit and should be denied. The rates proposed by GTE in the 1993 Annual Access tariff filing are reasonable and should be allowed to become effective immediately.

A. 1. The TBO should be afforded exogenous treatment because it comes within the Commission's rule and within the Commission's explicit intent when it adopted its rule.

The Commission's rule[1] provides for exogenous treatment of costs triggered by administrative, legislative or judicial action beyond the control of the carriers.[2] The facts involving the TBO come right within the FCC's specification. The triggering action – activation of the SFAS-106 accounting requirement by the FCC's approval – represents administrative action that is totally beyond the

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1 *See* Treatment of Local Exchange Carrier Tariffs Implementing [SFAS-106], CC Docket No. 92-101 ("*D.92-101*"), Memorandum Opinion and Order, 8 FCC Rcd 1024 (1993), *petition for review pending*, No. 93-1168 (D.C. Cir. February 19, 1993) ("*OPEB Order*").

2 *See* 47 CFR Sections 61.44-45.

control of the LECs. The clear indication of the Commission in adopting price caps[3] in the *Price Caps Order* was that exogenous treatment would be granted if four conditions were met: (i) actual issuance of a FASB requirement, (ii) notice by the companies to the FCC, (iii) an FCC finding of compatibility with its regulatory accounting needs, and (iv) FCC authorization of the accounting change.[4] All four of these conditions have been met.

Nonetheless, the *OPEB Order* denies exogenous treatment on the basis of an understanding of the exogenous principle not even hinted at in the Commission's rule, in the *Price Caps Order*, or in the *Price Caps Reconsideration Order*. Under this new understanding, "a lack of control over the regulatory action is not enough of a showing to justify exogenous treatment."[5]

Under the *OPEB Order*, the shape and substance of the rule is completely different. It is not a question of whether the governmental action is under the control of the carrier; it is whether the carrier controls the circumstances that underlie the governmental action.

The cited precedent for this decision is the Commission's "decision to deny exogenous treatment of depreciation rates."[6] In the case of depreciation,

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3 For the Commission's *Price Caps* program, *see* Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313 ("*D.87-313*"), 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990) ("*Price Cap Order*"), *modified on recon.*, 6 FCC Rcd 2637 (1991) ("*Price Cap Reconsideration Order*"), *aff'd. sub nom.* National Rural Telecom Association, 988 F.2d 174 (D.C. Cir. 1993).

4 *Price Caps Order*, 5 FCC Rcd at 6807.

5 *OPEB Order* at 1033.

6 *Id.*, footnote omitted.

the denial of exogenous treatment was formulated and expressly stated as part of the Commission's policy in the first instance. No such statement was made concerning OPEB matters.

But for depreciation, in terms of what the FCC considered the driver of the whole process ("the major determinant of the amount of depreciation expenses"[7]), *i.e.*, the investment-procurement decision, no outside party is involved. This is not true in the case of the TBO since the process does not occur entirely within the company, and it cannot be controlled by the company in any sense analogous to the investment-procurement process the Commission considers key to depreciation decisions.

AT&T (at 10) says it "does not disagree with [the] observation" that "significant considerations, such as labor relations, public relations, principles of ethical behavior, and the ability to attract qualified employees, impose practical limits on [GTE's] ability to alter the retiree benefits represented by the OPEB TBO." Nonetheless, AT&T (at 9) continues to insist that, so long as GTE is not bound by a labor contract or similar legal provision, "they have the ability to control the TBO."

AT&T (at 11-12) and MCI (at 21) both would have it that any degree of control whatever obviates exogenous treatment. MCI (*id.*) says: "While it is true that GTE has taken into account the fact that its work force wanted some level of OPEB, to suggest that GTE has never controlled the amount of OPEBs to be offered, and has no control over the costs associated with OPEBs is incredibly simplistic."

Thus, according to AT&T and MCI, not only would the Commission in the *OPEBs Order* have moved the test from one focused on "administrative,

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7 *Id.*

legislative, or judicial action" to one focused on the circumstances that underlie that governmental action; it would have, at the same time, insisted that there must be no trace of carrier control whatever. But neither AT&T nor MCI cite any FCC statement to this effect. The combination of both of these steps -- if they had been intended by the Commission -- would have been a transparent decision to remove any content whatever from the exogenous rule, for no set of circumstances would ever be likely to occur in which there would not be some trace of arguable control.

The Commission's intent must be taken to be a reasonable notion of control. Distorting GTE's position, MCI says (at 21, footnote omitted): "GTE ironically maintains any action by an outside body, the FCC, FASB, or any legislative body should be granted exogenous treatment within price caps. GTE fails in this argument, since under its own interpretation, virtually nothing would be endogenous to the price cap formula."

But it is MCI that is arguing a position that would strip the FCC's rule of any real meaning. GTE is not here maintaining action by the FASB alone justifies exogenous treatment; that action was superseded by the Commission's action to implement SFAS-106, which represented governmental action beyond the control of GTE within the meaning of the Commission's rule. As for the underlying circumstances, for all the reasons reviewed in GTE's Direct Case, those circumstances reflected in the TBO cannot be said to be substantially within the control of GTE.

These circumstances impose important and real limitations on the company's freedom of action. The effect of these limitations on GTE's ability to exercise "control" is no less real where there is no legally binding obligation in the sense of legislation or court orders or collective bargaining agreements. To assume total freedom of action on the part of the company -- and therefore

"control" – merely because there is not a relevant legally binding commitment would empty the exogenous rule of all meaning because there will never arise a case where there is not some possibility, by some far-fetched or absurd scenario, of company management taking different action. The extent of the control can be reflected in the Commission's decision by attending partial exogenous treatment.

AT&T (at 15) maintains that SFAS-106 "does not impose any new economic burden on the LEC's". Similarly, MCI states that "while [SFAS-106] is useful for financial reporting, the basic fact is that there is no real cost change". In each statement, the operative word is "change" or "new". Yet what GTE seeks adjustment for are the costs incurred prior to the adoption of SFAS-106, *i.e.*, the TBO liability. This is not "new", nor is it the result of a "change". The employee services that underlie the TBO occurred years ago. These are benefits not yet paid for by the company that FASB, after ten years of study, concluded should be recognized and quantified. While a firm can have some marginal effect on its expenses for health care, the driving element is the health care cost trend rate – which is clearly out of the control of the employer.

In summary: The Commission should provide for exogenous treatment for the TBO and related components of OPEBs inasmuch as they constitute a reasonable and necessary cost coming within the exogenous definition, it will not be unduly complex to implement, and any concerns can be offset by GTE's true up proposal.

2. Commission policy on intragenerational provision for intragenerational cost supports exogenous treatment of the TBO.

The Commission has been relatively unwavering on its stance that expenses of the firm incurred to provide service which benefits the ratepayer today should be borne by the ratepayer using the service today. Costs for service today should not be shifted to future ratepayers that have not benefitted from the previously provided service. In other words, costs should be incurred and relieved intra-generationally as opposed to inter-generationally. Thus, the Commission's policy dictates that the TBO portion of OPEB costs should not be pushed out to burden future generations, but should be recovered currently.

3. LEC current earnings are irrelevant to the exogenous issue.

AT&T asserts (at 19):

> [E]ven with the accrued OPEB expense already reflected on their earning reports, most of the price cap LECs are earning at levels that have required them to make sharing adjustments in their 1993 annual access filings. Given this fact, the LECs are in no position to claim that failure to receive exogenous treatment would be unfair.

This statement is misleading in that no GTE jurisdictions included the full accrual of OPEB costs in its 1992 earnings reports (Report 492); and, despite that fact, fewer than 25% of GTE's jurisdictions filed for sharing adjustments. Furthermore, as AT&T footnotes (at n.41), few GTE jurisdictions even qualify for low end adjustment, again in the absence of the higher SFAS-106 OPEB expense.

More importantly, the current earnings position of any LEC is irrelevant to the Commission's decision here which involves application of the Commission's exogenous rule. Thus, AT&T's argument concerning LEC earnings is irrelevant.

B. GTE continues to oppose add-back for sharing and lower formula adjustments. The Commission should defer resolution of this issue to the on-going rulemaking proceeding.

GTE has opposed adding-back for sharing and the Lower Formula Adjustment ("LFAM") in both its Direct Case[8] and in the rulemaking proceeding specifically considering this issue.[9] Since the issue was not specifically addressed in the original price cap rules, the add-back issue cannot be resolved by interpreting the current rules. GTE believes that this issue cannot be resolved in this context of this investigation. The Commission has properly established a rulemaking to consider this issue. Once new rules are adopted, they should be applied prospectively.

In its Direct Case, GTE argued that the Commission should properly consider the add-back issue in the context of the established rulemaking. Ad Hoc (at 14-19) mischaracterizes this as a"retroactive rulemaking" argument.[10] In fact, GTE argued that since the Commission itself recognized in establishing the rulemaking that "this issue was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules,"[11] LECs should not be held to some standard the Commission had yet to propose in determining the reasonableness of the rates filed. While the Commission can clearly promulgate new rules going forward, this rate investigation should determine whether the rates were

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8 Direct Case of GTE, filed July 27, 1993 at 25-30,

9 In the Matter of Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment, Notice of Proposed Rulemaking, CC Docket No. 93-179, FCC 93-325, released, July 6, 1993. Comments of GTE, filed August 2, 1993, and Reply Comments of GTE, filed September 1, 1993.

10 Ad Hoc at 14, n.28.

11 Sharing Proceeding at ¶4.

reasonable under the rules in effect at the time the rates were filed, not based upon some rules that the Commission will adopt in the future.

In general, MCI and Ad Hoc argue that add-back is implied in the current Commission rules. They base this conclusion on two arguments. First, they believe that sharing should be treated the same as overearnings under price cap regulation so that sharing is effectively a refund. Second, they agree with the Commission's tentative conclusions detailed in the add-back rulemaking that the Commission intended sharing be treated as a refund under rate of return ("ROR") regulation. These arguments, which proceed on the false premise that the sharing backstop is supposed to operate in much the same way as ROR enforcement, conflict with the basic underpinnings of the price cap plan.

The backstop mechanism was included in the basic price cap plan and was designed to provide protection in both directions. It protected the ratepayer from extreme rates in excess of the compensatory level, and it protected the carrier from extreme compensation. Treatment of sharing as a refund under rate of return regulation was never considered in the original LEC price cap proceeding. However, this backstop mechanism was never intended to negate the whole purpose of the price cap plan, nor to return to the regulatory system to ROR regulation. This mechanism was established as a forward-looking one-time adjustment to the Price Cap Index ("PCI").[12] If a carrier can meet its formidable productivity commitment and then above and beyond that produce savings that can be shared with ratepayers, those savings are factored into the PCI for the following year – one year only.

Ad Hoc (at 12-13) and MCI also argue for asymmetrical treatment of sharing and LFAM on the grounds that the method of calculating over and under

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12 Second Report and Order, 5 FCC Rcd 6786, 6803 (1990).

earnings under ROR regulation are also employed under price cap regulation. Specifically, they believe that sharing is equivalent to a refund and LFAM is equivalent to a rate increase. While they believe add-back of sharing is consistent with the Commission's price cap regulatory regime, they believe add-back does not apply with regard to LFAM since it "would not be consistent with the Commission's past application of its rate of return requirements, or with the underlying purpose of the [LFAM] adjustment."[13] No support is provided for their belief that sharing and LFAM must be treated the same as under rate of return regulation. The Commission abandoned rate of return regulation and adopted price caps with a productivity backstop, not over/underearnings monitoring. Therefore, arguing that sharing and LFAM must be treated the same is totally unsupported.

In summary: The issues of add-back should be deferred to the rulemaking proceeding since the issue was not addressed in the original price cap rules. If new rules are adopted any rate adjustment should be prospective.

### C. GTE opposes establishing a new service category for the LIDB Query element.

AT&T (at 37-41) disputes the LECs' assignment of the LIDB Query charge to either the Local Transport or the Switching category. Instead, AT&T advocates establishing a new service category within the Traffic Sensitive basket solely for this element. AT&T claims that including the LIDB Query charge in either the Local Transport category or the Switching category could result in unreasonable and unjustifiable pricing of the query charge relative to other

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13 Ad Hoc at 13.

elements within the categories. AT&T claims that placing this rate element in a new service category would eliminate concerns of excessive pricing.

GTE opposes establishing a new service category for this element. Not only is a new service category unnecessary, but creation of a separate service category conflicts with the Commission's original Price Cap goal of simplifying regulation of LECs. The practical effect of establishing a new service category for LIDB Query charge would be to create rate element level banding. The Commission earlier rejected such rate element banding during the development of the Price Cap plan when it determined that the public interest is better served by bands at the service category level rather than the rate element level. Using AT&T's logic, a separate service category would be required for all new services where, in AT&T's opinion, competition has not developed sufficiently to eliminate the possibility of rate manipulation by the LECs. Placing this single element in its own category would severely restrict the LECs' ability to respond to developing markets.

GTE is concerned that efforts to establish separate service categories for each new service will undermine the Commission's objective to encourage innovation and introduction of new services by the LECs. Innovative new services may not have competitors at the time of introduction. If the sole justification of placing each new service in a separate category is to control the LECs pricing flexibility until competition develops, what motivation will the LECs have to introduce new services? The Commission's price cap plan was not intended to create an ever-increasing number of service categories or baskets in order to restrict LEC pricing flexibility.

Another concern is that establishing a separate service category for LIDB Query may cause unwanted rate adjustments. With no other rates in the category, LIDB Query rates would change because of unrelated adjustments to

the price cap indices in the annual filing or due to exogenous costs. Under these circumstances, the LEC may have no choice but to change the LIDB Query rate. This has already occurred to the Database 800 rates because of changes required in the 1993 annual filing and the GSF filing.

While GTE believes that the most appropriate category for LIDB Query charge is Local Transport in the Traffic Sensitive basket, as an alternative, LIDB Query could be included in the 800 Database category, the category established by the *Data Base Access Order.*[14] This should resolve AT&T's concern that the LECs might increase the rate for this element in order to reduce other rate elements in the Local Transport basket.

Ad Hoc proposes (at 24-25) that the Commission undertake a rulemaking proceeding in order to develop specific requirements and functional guidelines that will aid in the assignment of new services to new categories. GTE opposes such a limited proceeding. It would be more appropriate to consider this issue in the scheduled review of the LECs' price cap plan in 1994. By including this issue in the review, consideration of all aspects and impacts on price cap LECs can be considered.

GTE does not believe that specific requirements and functional guidelines can be developed to apply to all potential new services. As technological changes occur, new services will be developed and introduced which may not fit conveniently in the guidelines. If flexibility and/or options are not provided, the guidelines are worthless and the time spent in developing them has been wasted. Inflexibility will also require continued review and modification in order to keep up with technology. GTE does not believe that the objectives of the

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[14] Memorandum Opinion and Order, 8 FCC Rcd 907 (1993).

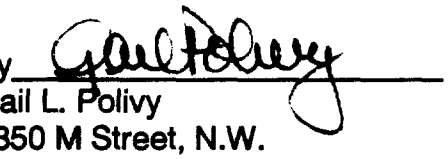
Commission's price cap plan, to afford the LECs pricing flexibility, increase competition and reduce unnecessary regulations, should be compromised.

In summary, a new service category should not be created for the LIDB Query. Not only is a new service category unnecessary, but creation of a separate service category conflicts with the Commission's original Price Cap goal of simplifying regulation of LECs and would undermine the Commission's objective to encourage innovation and introduction of new services by the LECs. Moreover, a separate service category for LIDB Query may cause unwanted rate adjustments.

For the foregoing reasons and the justification provided in the Direct Case the Commission should allow the rates to go into effect as filed.

Respectfully submitted,

GTE Service Corporation and its affiliated GTE domestic telephone operating companies

By 

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September 10, 1993

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## Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "Rebuttal of GTE" have been mailed by first class United States mail, postage prepaid, on the 10th day of September, 1993 to all parties on the attached list.

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